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## Soil Expenditures

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# Agricultural Law Digest

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## Soil Expenditures

by Neil E. Harl\*

Historically, expenditures to improve the productivity of soil have been viewed as capital in nature and not deductible.<sup>1</sup> Over the past four decades Congress has acted to make some expenditures deductible if specified conditions are met.<sup>2</sup>

**Fertilizer and lime.** Before enactment of the provision permitting a current deduction for fertilizer, lime and other soil conditioning expenditures,<sup>3</sup> soil conditioning expenses were considered as capital expenditures if the effect lasted for more than one year.<sup>4</sup> Indeed, as recently as 1989, IRS took the position that the cost of fertilizer applied to an existing stand of timber could not be deducted immediately and had to be amortized.<sup>5</sup>

In 1960, Congress responded to pleas of farmers for more certainty in handling expenditures for fertilizer and other soil amendments and approved legislation providing for *an election* to deduct expenditures for fertilizer, lime and other soil amendments or conditioners.<sup>6</sup> The election is available despite the carryover in the soil of benefits to later years.<sup>7</sup> Under the statutory provision authorizing a current deduction, expenditures may be deducted that are paid or incurred during the taxable year for the "purchase or acquisition of fertilizer, lime, ground limestone, marl, or other materials to enrich, neutralize or condition land used in farming."<sup>8</sup>

**Land used in farming.** The term "land used in farming" is defined as land used by a landowner or tenant for

the production of crops, fruits or other agricultural products or for the sustenance of livestock.<sup>9</sup> Expenditures on land brought into production *for the first time* apparently are not eligible for the election to deduct the expense currently.<sup>10</sup> For land used by the immediately preceding owner for farming purposes, the taxpayer is considered to be using the land in farming when the expenditures are made if the taxpayer's use of the land is substantially a continuation of its use in farming, whether for the same farming use as that of the predecessor or any of the other permissible uses.<sup>11</sup>

**Business of farming.** The election to deduct fertilizer and other soil conditioner expenses currently may be made *only by a taxpayer engaged in the business of farming*.<sup>12</sup> The statute uses the same definition of "business of farming" as is used for purposes of the soil and water expense deduction.<sup>13</sup> To be engaged in the business of farming, a taxpayer must be engaged in a farming operation, be leasing under a crop share or livestock share lease or be materially participating in the operation or management of the farm in the case of a cash rent lease.<sup>14</sup> Thus, fertilizer, lime or other soil amendments applied by a landowner under a cash rent lease are not eligible for the election to deduct currently *unless the landowner is materially participating*<sup>15</sup> and that is not easy to do.

A nursery engaged in the raising of ornamental plants is considered in the business of farming for purposes of the election.<sup>16</sup>

**Government farm programs.** With a cash rent landlord often not eligible to make the election to deduct expenses currently, is land idled under the 10-year Conservation Reserve Program<sup>17</sup> or the annual land retirement programs eligible for the election? Legislation was enacted for the 1983 payment-in-kind (PIK) farm program and

subsequently extended to the 1984 wheat PIK program to solve the problem of trade or business status for some purposes.<sup>18</sup> Participation in the PIK program would have produced cash-rent like income. Under the 1983 legislation *which was not added to the Internal Revenue Code*, land idled under the PIK program was considered for a "qualified taxpayer" to have the same status as though commodities had been produced on the land.<sup>19</sup> "Qualified taxpayer" status required that the taxpayer receive agricultural commodities in exchange for idling land under the PIK program.<sup>20</sup> Although the legislation was not specifically directed to fertilizer and lime expenditure, enactment of the provision raises a question whether land idled under government farm programs is considered used in a trade or business without legislation of the type adopted in 1983. Clearly, there is a question whether fertilizer and lime are eligible for the election to deduct if applied to land idled under the CRP or other federal government land idling program.

**The election.** The election to deduct fertilizer, lime, and other soil conditioner expenses currently is made by claiming the deductions on the appropriate schedule on the income tax return.<sup>21</sup> Revocation of the election requires the consent of the District Director of Internal Revenue and is made by application to that office with a statement of reasons for the requested action to revoke.<sup>22</sup>

As a practical matter, most farm taxpayers assume that expenditures for fertilizer, lime and like materials are currently deductible and give little thought to the election procedure. But the election should be made with care if current deductibility is desired. Similarly, if for some reason a higher level of taxable income is desired, the election should not be made.

The regulations specify that an election is not required for those expen-

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ditures that are not capital in nature.<sup>23</sup> Thus, for fertilizer, lime and other soil amendments applied in the year of crop use, with no significant carryover to a later year, an election should not be required. The problem is that there is almost always some carryover.

**Purchase of farm.** On the purchase of a farm, can the allocation of the purchase price among the depreciable and nondepreciable components of the purchase include an allocation to fertility build up in the soil? There is no direct authority sanctioning that practice, but

an argument can be made that such an allocation would be appropriate if the conditions for an election to deduct currently are met.

### FOOTNOTES

- <sup>1</sup> *E.g.*, Ewing B. Swaney, 5 B.T.A. 990 (1927), *acq.*, II-2 C.B. 7 (cost of liming deductible over four years at 25 percent per year); H. L. McBride, 23 T.C. 901 (1955), *acq.*, 1955-2 C.B. 7 (clearing trees for orchard).
- <sup>2</sup> I.R.C. §§ 175, 180, 182 (repealed in 1986).
- <sup>3</sup> I.R.C. § 180.
- <sup>4</sup> See, e.g., J. H. Sanford, 2 B.T.A. 181 (1925); Ewing B. Swaney, 5 B.T.A. 990 (1927), *acq.*, II-2 C.B. 7).
- <sup>5</sup> GCM 39791, 1989.
- <sup>6</sup> I.R.C. § 180, Pub. L. 86-779, 74 Stat. 1001 (1960).
- <sup>7</sup> See I.R.C. § 180.
- <sup>8</sup> I.R.C. § 180(a).

<sup>9</sup> I.R.C. § 180(b).

<sup>10</sup> *Id.*

<sup>11</sup> Treas. Reg. §§ 1.180-1(b), 1.175-4(a).

<sup>12</sup> I.R.C. § 180(a). See Treas. Reg. §§ 1.180-1(b), 1.175-3.

<sup>13</sup> Treas. Reg. § 1.180-1(b).

<sup>14</sup> Treas. Reg. § 1.175-3.

<sup>15</sup> Treas. Reg. § 1.175-3. See Maple Leaf Farms, Inc., 64 T.C. 438 (1975), *acq.*, 1975-2 C.B. 2 (to be considered in business of farming, farm owner must participate to significant degree in growing process and must be at substantial risk of loss from growing process); Ltr. Rul. 8724003, January 30, 1987 (expenditures not deductible where

farm cash rented and managed by third party manager).

<sup>16</sup> See Rev. Rul. 59-12, 1959-1 C.B. 59.

<sup>17</sup> 7 U.S.C. § 3831, added by Pub. L. 99-198, Sec. 1231, 99 Stat. 1509 (1985).

<sup>18</sup> Payment-in-Kind Tax Treatment Act of 1983, Pub. L. 98-4, Sec. 3, 97 Stat. 7 (1983); Tax Reform Act of 1984, Sec. 1061.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> See Treas. Reg. § 1.180-2.

<sup>22</sup> Treas. Reg. § 1.180-2.

<sup>23</sup> Treas. Reg. § 1.180-1(a).

## FEDERAL TAX UPDATE

by Neil E. Harl

### AUTOMOBILE TRADES\*

Practitioners have raised a question about the handling of trades involving automobiles used for both business and personal use under the listed property rules. The IRS position is detailed in IRS Pub. 917, "Business Use of a Car" (Rev. Nov. 1988). The following examples illustrate both the IRS approach and another approach (keep in mind that examining agents are more likely to look for adherence to the IRS approach).

#### Example

On April 15, 1987, Elmer Fudd purchased and placed in service a new Cadillac with a purchase price of \$28,000. The automobile is used 40 percent in the farm business and 60 percent for personal use. Because business use is less than 51 percent, no expense method depreciation is claimed. For vehicles placed in service during 1987, depreciation is limited to \$2,560 the first year, \$4,100 for the second year, \$2,500 for the third year and \$1,475 for each succeeding year. On January 2, 1996, Fudd trades the automobile for a new Cadillac and pays \$17,500 in cash. At that time, the Cadillac traded in has a fair market value of \$14,000.

### IRS APPROACH

Adjusted basis of old automobile—

Cost	\$28,000
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Less depreciation claimed  
(figured at 100% business use)

1987	\$2,500
1988	\$4,100
1989	\$2,550
1990	\$1,474
1991	\$1,475
1992	\$1,475
1993	\$1,475
1994	\$1,475
1995	\$1,475
1996	\$738

Total depreciation    \$18,798

Depreciation actually claimed

40% x \$18,798 = \$7,519

\$7,519

Adjusted basis of old automobile

\$20,481

Basis of new automobile for depreciation

Adjusted basis of old auto    \$20,481

Plus boot paid    \$17,500

Basis before adjustment    \$37,981

\$37,981

Less depreciation attributable to

personal use    \$18,798

-\$7,519

\$11,279

\$11,279

Basis for depreciation

\$26,702

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